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# New asset class risk

Scott Eason

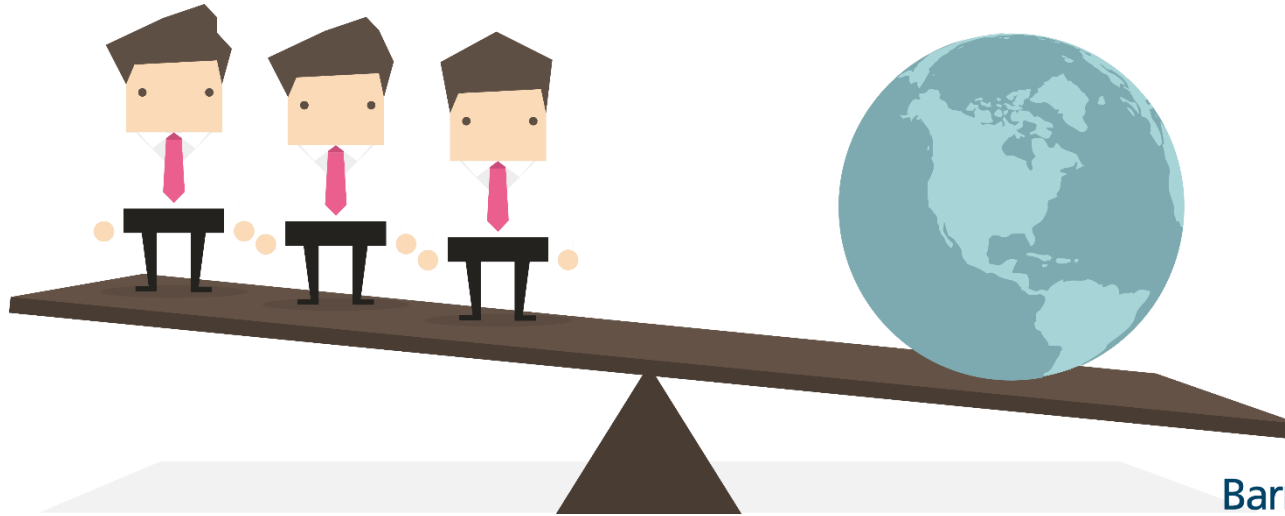


2 February 2017

# Houston, we have a problem...

Insurers don't have endless  
resource / expertise

Investment risks / knowledge  
requirements are getting bigger



# Houston, we have a problem...

Insurers don't have  
endless resource

The CIO / Investment Risk  
requirements are getting bigger



...but I'm going to propose a practical, cost-efficient  
solution

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# Agenda...

1

Why has the problem arisen?

2

What can we do about it?

3

Questions and conclusions

## SCOTT EASON

- Partner and Head of Insurance Consulting
- Formerly CIO at Legal & General and Partnership
- Ex-NED and Member of the Investment Committee for a Friendly Society

# Executive Summary!

## Why it has arisen?

- Investment conditions have changed
- Investment universe has widened
- Insurance requirements have changed

## What is the solution?

- Work as a team
- Maximise utilisation of expertise



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# Why has the problem arisen?



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# Investment for insurers has changed

- **Solvency II introduces new metrics and potentially new goals**
  - formalises Prudent Person Principle
- **2016 surprised politically**
  - “lower for longer” following Brexit
  - Trumpflation
- **Investment universe for insurers continues to widen**

# Why new asset classes?

## Heavily visited economic rationale

- “lower for longer” following Brexit
- Bank lending reduced
- Search for “illiquidity premium”

## However, the real reason is because others are!

- Successful companies have to have a competitive advantage AND
- Meet a minimum level in other areas including investment
- Applies to all types of insurance funds



# New asset classes

INVESTMENT  
DECISION

REPORTING

RISK  
MANAGEMENT

# Investment decision

- Does it meet ABC's?
- Expected Return
- Volatility
- Correlation of risks
- Capital treatment
- MA eligibility
- Availability / segregated fund sizes
- Concentration of risks
- Manager expertise
- Fees

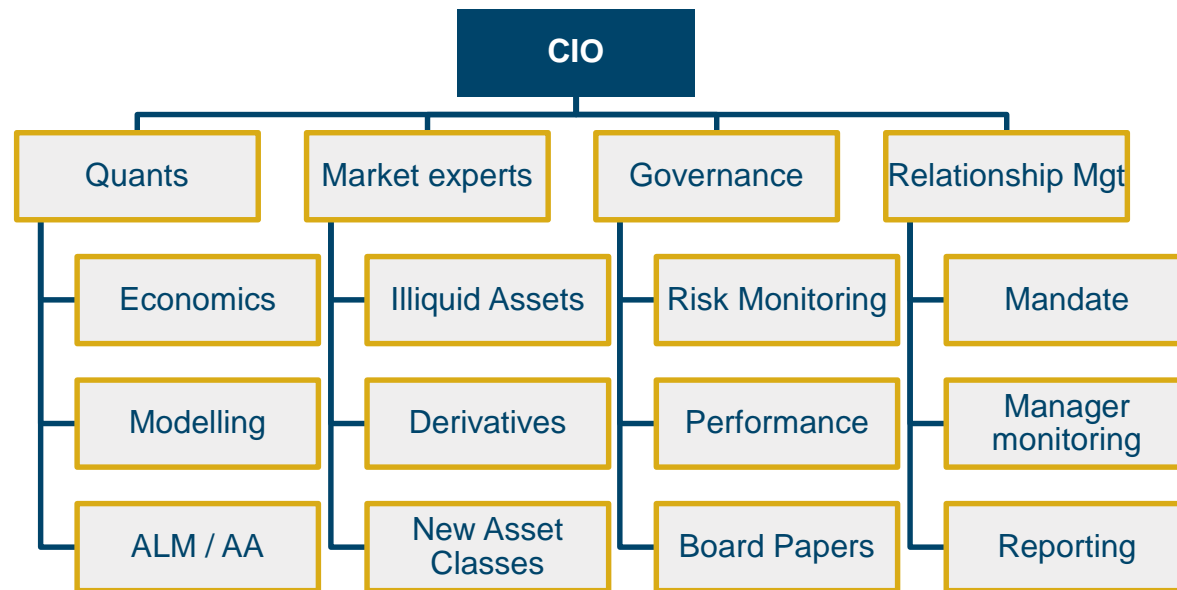


# Reporting

- Valuation
- Look-through?
- Standard Formula Appropriateness
- Internal Model
- Credit Ratings
- MA



# CIO Tasks / Responsibilities



# Risk Management

- Risk limits (risk factors, diversification)
- MI needs
- Risk review of asset allocation / pricing decisions



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**Does the investments team have enough expertise to invest in new asset classes?**



# Risk Management

- Risk limits (risk factors, diversification)
- MI needs
- Risk review of asset allocation / pricing decisions

**Does the investments team have enough expertise to invest in new asset classes?**

**Does the risk team have enough expertise to challenge the investments team?**





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# What can we do about it?

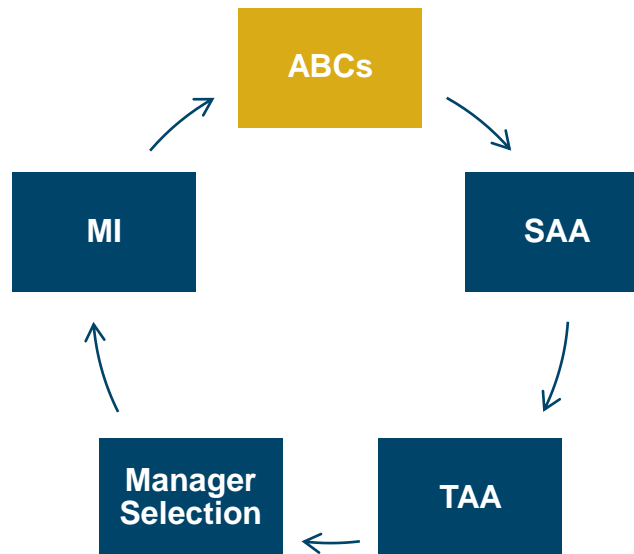


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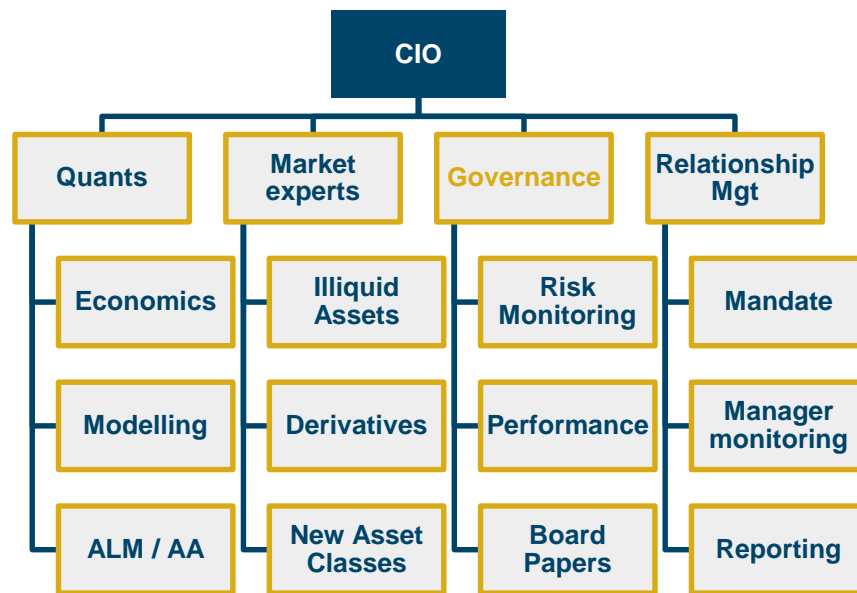
# Work as a team (1)

- Ensure that delegation / decisions are easier by having a clear statement of investment principles
- Extremely important to be singing from the same hymn sheet
  - Review ABC's

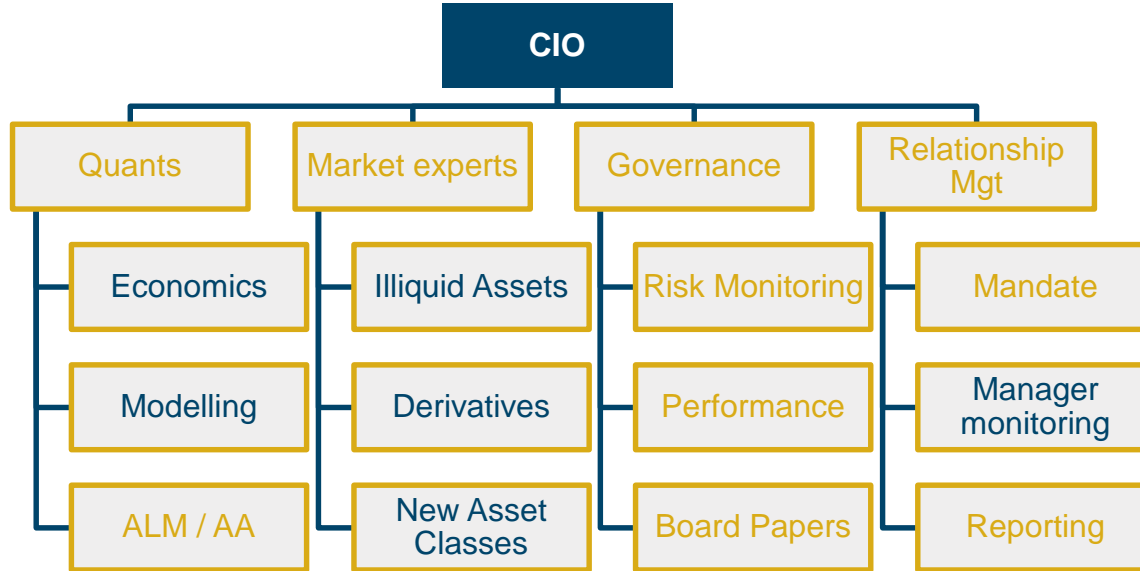


## Work as a team (2)

- Make sure your investment managers are working for you, not themselves!
- Ensure MI is giving you what you need
  - Explanations of risks / performance drivers
- Receive data required for reporting



# Utilising external expertise



# Case Study

- **Annuity writer had added a number of illiquid loan classes to its portfolio**
  - Priced each transaction on a bespoke basis
  - Used an asset allocation model to determine available yield for pricing model
  - Optimisation based on expected yield (net of fees), S2 capital and risk limits
- **Risk function wanted to carry out an Assurance Review of model**

# Case Study

- **We were hired to provide independent investment expertise to support the risk team**
- **We were asked to review:**
  - The appropriateness of the methodology and assumptions used by the model;
  - The appropriateness of the implementation of the methodology and assumptions in the model;
  - The consistency of the typical target asset portfolio produced with the Company's risk appetite;
  - The fitness for purpose of the documentation of the methodology and assumptions used in the model

# Case Study

- **Outcome of our review**
  - Lots of subjectivity in the model
  - Alternative methodologies, assumptions, capital interpretation existed
  - Carried out various stress tests to test these
  - Documentation was weak
- **With a few minor tweaks, model was classified as effective and confirmed not to contain user bias**

**Questions**

**Comments**



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# Conclusions

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## What is the solution?

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